

A. ORIGIN OF THE UNITED NATIONS MODEL CONVENTION

The desirability of promoting greater inflows of foreign investment to developing countries on conditions which are politically acceptable as well as economically and socially beneficial has been frequently affirmed in resolutions of the General Assembly and the Economic and Social Council of the United Nations and the United Nations Conference on Trade and Development. The countries participating in the Paris Conference on International Economic Cooperation held in 1963-1964 recognized that foreign private capital flows and investment play an important complementary role in the economic development process, particularly through the transfer of resources, managerial and administrative expertise and technology to the developing countries, the expansion of productive capacity and employment in those countries and the establishment of export markets.

The growth of investment flows from developed to developing countries depends to a large extent on what has been referred to as the international investment climate. The prevention or elimination of international double taxation — i.e., the imposition of similar taxes in two or more States on the same taxpayer in respect of the same base — whose effects are harmful to the exchange of goods and services and to the movement of capital and persons, constitutes a significant component of such a climate. Broadly, the general objectives of bilateral tax conventions may today be seen to include the full protection of taxpayers against double taxation (whether direct or indirect) and the prevention of the discouragement which taxation may provide for the free flow of international trade and investment and the transfer of technology. They also aim to prevent discrimination between taxpayers in the international field, and to provide a reasonable element of legal and fiscal certainty as a framework within which international operations can be carried on. With this background, tax treaties should contribute to the furtherance of the development aims of the developing countries. In addition the treaties have as an objective the improvement of cooperation between taxing authorities in carrying out their duties.

Substantial progress towards the elimination of double taxation has been made through unilateral relief measures and more particularly through bilateral tax conventions, which have emerged since the 1960s as a salient feature of inter-State economic relations. However, until 1965, only a relatively small number of treaties had been concluded between developed and developing countries, the reason being probably the fact, acknowledged in 1965 by the Fiscal Committee of the Organisation for Economic Cooperation and Development, that “the traditional tax conventions have not commended themselves to developing countries.”¹ According to that Committee, “the essential fact remains that tax conventions which capital-exporting countries have found to be of value to improve trade and investment among themselves and which might contribute in like ways to closer economic relations between developing and capital-exporting countries are

¹ Organization for Economic Cooperation and Development: *Fiscal Incentives for Private Investment in Developing Countries: Report of the OECD Fiscal Committee* (Paris, 1965), para. 164.

not making sufficient contributions to that end...Existing treaties between industrialized countries sometimes require the country of residence to give up revenue. More often, however, it is the country of source which gives up revenue. Such a pattern may not be equally appropriate in treaties between developing and industrialized countries because income flows are largely from developing to industrialized countries and the revenue sacrifice would be one-sided. But there are many provisions in existing tax conventions that have a valid place in conventions between capital-exporting and developing countries too.”²

The desirability of encouraging the conclusion of bilateral tax treaties between developed and developing countries was recognized by the Economic and Social Council of the United Nations, which in its resolution 1273 (XLIII) adopted on 4 August 1967 requested the Secretary-General “to set up an ad hoc working group consisting of experts and tax administrators nominated by Governments, but acting in their personal capacity, both from developed and developing countries and adequately representing different regions and tax systems, with the task of exploring, in consultation with interested international agencies, ways and means for facilitating the conclusion of tax treaties between developed and developing countries, including the formulation, as appropriate, of possible guidelines and techniques for use in such tax treaties which would be acceptable to both groups of countries and would fully safeguard their respective revenue interests.” Pursuant to that resolution, the Secretary-General set up in 1968 the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries, composed of tax officials and experts from developed and developing countries, appointed in their personal capacity.

The Group of Experts completed the formulation of guidelines for the negotiation of bilateral treaties between developed and developing countries in the course of seven meetings, from 1968 to 1977, which were attended by members from Argentina, Brazil, Chile, France, Federal Republic of Germany, Ghana, India, Israel, Japan, the Netherlands, Norway, Pakistan, the Philippines, Sri Lanka, the Sudan, Switzerland, Tunisia, Turkey, the United Kingdom of Great Britain and Northern Ireland and the United States of America. These meetings were also attended by the observers from Austria, Belgium, Finland, the Republic of Korea, Mexico, Nigeria, Spain, Swaziland and Venezuela and from the following international organizations: the International Monetary Fund, the International Fiscal Association, the Organisation for Economic Cooperation and Development, the Organization of American States and the International Chamber of Commerce. The guidelines are contained in the “Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries.”³ According to Economic and Social Council resolution 1541 (XLIX), the guidelines should represent “an important form of technical assistance for the conclusion of future treaties.”

2 Organization for Economic Cooperation and Development: *Fiscal Incentives for Private Investment in Developing Countries: Report of the OECD Fiscal Committee* (Paris, 1965), paras. 163 and 165.

3 United Nations Sales publication, Sales No. E.79.XVI.3.

At its Seventh Meeting, the attention of the Group of Experts was drawn to the fact that the Group of Eminent Persons appointed in 1974 by the Secretary-General pursuant to Economic and Social Council resolution 1721 (LIII) had stated in its report to the Secretary-General that “If, through the work of the Group of Experts on Tax Treaties, the provisions of these treaties could be standardized, with only a small number of clauses to be negotiated in particular cases, they would in fact amount to an international agreement on taxation, which ...[the Group of Eminent persons considers] to be the final objective.”⁴

The Group of Experts took the view that the world-wide multilateral tax agreement recommended by the Group of Eminent Persons would not seem feasible during the forthcoming decade but, recognizing the seriousness and urgency of many of the issues singled out by the latter, agreed that it was imperative that those issues be dealt with through an adequate network of bilateral tax treaties. According to the Group of Experts, it would therefore seem appropriate for the competent United Nations bodies to urge Member States to embark as soon as possible on a policy of entering into such treaties. In that connection the Group of Experts expressed readiness to consider a draft model bilateral convention between a developed and a developing country based on the guidelines already developed by the Group, which the United Nations Secretariat might wish to prepare as a follow-up to the work of the Group at its first seven meetings.

In his report to the first regular session of 1978 of the Economic and Social Council on the work of the Group of Experts at its Seventh Meeting, the Secretary-General expressed the view that “the completion of a model bilateral convention for possible use by developed and developing countries constitutes a logical follow-up to the work done by the Group of Experts relating to the formulation of guidelines and would moreover be consonant with the recommendation of the Group of Eminent Persons that “bilateral tax treaties should be as uniform as possible so as to prepare the way for an international tax agreement” (see E/1978/36, para.15). At that session, the Economic and Social Council adopted decision 1978/14, in which it welcomed the position of the Secretary-General as set forth above and requested the Group of Experts” to complete its consideration of a draft model bilateral convention at its Eighth Meeting in 1979.”

The United Nations Secretariat therefore prepared a draft model convention (ST/SG/AC.8/L.29) consisting of articles reproducing the guidelines formulated by the Group of Experts, together with commentaries thereon incorporating the views of the members of the Group as expressed at its various meetings and also reproducing, where appropriate, the commentaries on the articles of the 1977 Model Double Taxation Convention on Income and on Capital of the Organisation for Economic Cooperation and Development, hereafter referred to as the OECD Model Convention. It may be recalled that in preparing the aforementioned guidelines the Group of Experts had decided to use the OECD Model Convention as its main reference text in order to take advantage of the

⁴ *The Impact of Multinational Corporations on Development and on International Relations* (United Nations publication, Sales No. E.74.II.A.5), page 92.

accumulated technical expertise embodied in that Convention and the commentary thereon, and also for reasons of practical convenience stemming from the fact that the Convention was being used by OECD member countries in the negotiation of tax treaties not only with each other but also with developing countries. However, it was fully understood that there was no presumption of correctness to be accorded to the OECD Model Convention, and that the decisions of the Group were in no way required to be governed by the OECD text.

The Group of Experts reviewed the draft United Nations Model Convention at its Eighth Meeting, held at Geneva from 10 to 21 December 1979, and adopted the final text of the Convention and of the commentary thereon. In 1980, the United Nations published the *United Nations Model Double Taxation Convention between Developed and Developing Countries* which was preceded in 1979 by the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries*. By its resolution 1980/13 of 28 April 1980, the Economic and Social Council renamed the Group of Experts as “Ad Hoc Group of Experts on International Cooperation in Tax Matters.” Presently, the Group of Experts is composed of twenty-five members — ten from developed countries and fifteen from developing countries and economies in transition.

In the 1990s, the Ad Hoc Group of Experts on International Cooperation in Tax Matters recognized that significant changes had taken place in the international economic, financial and fiscal environment. In addition, there has been the advent of new financial instruments, transfer pricing mechanisms, the growth of tax havens and the globalization affecting international economic relations as well as the subsequent OECD Model Convention revision and updates in 1992, 1994, 1995 and 1997. Consequently, the Eighth Meeting of the Group of Experts held in Geneva in December 1997 established a Focus Group consisting of five members and four alternates, to proceed with the revision and update of both the *United Nations Model Double Taxation Convention between Developed and Developing Countries* and the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries*.

Accordingly, following its Seventh Meeting (Geneva, 11 - 15 December 1995), Eighth Meeting (Geneva, 15 -19 December 1997), and the Focus Group meetings (New York, 9 & 10 December 1998) and (Amsterdam, 22 - 25 March 1999), the Group of Experts reviewed the amendments suggested by its members to the Articles and Commentary of the *United Nations Model Double Taxation Convention between Developed and Developing Countries*. These amendments were consolidated in the draft revised United Nations Model Convention presented before the Ninth Meeting of the Group of Experts held in New York from 3 to 7 May 1999. The Group of Experts adopted the revised *United Nations Model Double Taxation Convention between Developed and Developing Countries*, subject to editorial changes. The comments and suggestions received from the members of the Group of Experts on these changes were examined by a Steering Committee during its meeting held in New York from 12 to 14 April 2000. The meeting was attended by Mr. Antonio Hugo Figueroa (Argentina), who was appointed Chairman, Mr. Mayer Gabay (Israel), Mr. Noureddine Bensouda (Morocco), Mr. Mike Waters (United Kingdom) and Mr. Mordecai S. Feinberg (United States). The Secretariat was

represented by Mr. Abdel Hamid Bouab, Secretary and Mr. Suresh Shende, Assistant Secretary of the Group of Experts. The final text of the UN Model Convention as so modified was adopted on a consensual basis by the Steering Committee. It was decided that after the editorial changes had been effected, a revised version of the United Nations Model Convention would be published. Thus, the revision and update of the United Nations Model Double Taxation Convention between Developed and Developing Countries was undertaken by the Group of Experts, Focus Group and Steering Committee under the overall guidance and supervision of Mr. Abdel Hamid Bouab, Officer-in-Charge, Public Finance and Private Sector Development Branch, Department of Economic and Social Affairs, United Nations and Secretary, Ad Hoc Group of Experts, assisted by Mr. Suresh Shende, Interregional Adviser in Resource Mobilization and Assistant Secretary of the Group of Experts. The Steering Committee expressed its gratitude to Mr. Abdel Hamid Bouab for his knowledge, leadership and negotiating skills which contributed to the successful revision of the United Nations Model Double Taxation Convention between Developed and Developing Countries.

The main objectives of the revision of the United Nations Model Convention were to take account of developments since 1980 in the globalization of trade and investment and in the international tax policies of developed and developing countries.

The process of revision and update of the *United Nations Model Double Taxation Convention between Developed and Developing Countries* was initiated in 1995 and culminated in 1999 at the Ninth Meeting of the Group of Experts. The Ninth Meeting was attended by the following members: Antonio Hugo Figueroa (Argentina), Iraci Kahan (Brazil), Adélaïde Nare (Burkina Faso), Yukang Wang (People's Republic of China), Abdoulaye Camara (Côte d'Ivoire), Mona M.A. Kassem (Egypt), Hillel Skurnik (Finland), Helmut Krabbe (Germany), Seth E. Terkper (Ghana), Ravi Kant (India), Arie Soelendro (Indonesia), Mayer Gabay (Israel), William W. Adler (Jamaica), Karina Pérez Delgadillo (Mexico), Abdelali Benbrik (Morocco), Ernst Bunders (The Netherlands), Atef Alawneh (Palestine Authority), María Pastor (Spain), Daniel Luthi (Switzerland), John Brian Shepherd (United Kingdom) and Mordecai S. Feinberg (USA). Members from France, Japan, Nigeria and Pakistan did not attend the meeting.

The Meeting was attended by the following observers:

(a) Ken Allen (Australia), Claudine Devillet (Belgium), Carlos dos Santos Almeida (Brazil), Sandra Benedetto (Chile), Shubin Mu (People's Republic of China), Marcellin-Edgard Mebalet (Gabon), Dieudonné Bouddhou (Gabon), Vijay Mathur (India), Brahim Kettani (Morocco), Igor Yuri Noskov (Russian Federation), Babou Ngom (Senegal), Mike Waters (United Kingdom).

(b) Jacques Sasseville (OECD), Jeffrey P. Owens (OECD), Willem F. J. Wijnen (International Bureau of Fiscal Documentation), Francisco Alfredo Garcia Prats (University of Valencia, Spain), Marcus V. Föllmi (International Chamber of Commerce), Stephen R. Crow (International Association of University Presidents, USA).

The Group unanimously elected Antonio Hugo Figueroa and Hillel Skurnik as Chairman and Rapporteur respectively. Abdel Hamid Bouab, Officer-in-Charge of Public Finance

and Private Sector Development Branch served as Secretary and Suresh Shende, Interregional Adviser in Resource Mobilization as Assistant Secretary and Paul McDaniel as resource person.

The United Nations Model Convention represents a compromise between the source principle and the residence principle, although it gives more weight to the source principle than does the OECD Model Convention. As a correlative to the principle of taxation at source the articles of the Model Convention are predicated on the premise of the recognition by the source country that (a) taxation of income from foreign capital would take into account expenses allocable to the earnings of the income so that such income would be taxed on a net basis, that (b) taxation would not be so high as to discourage investment and that (c) it would take into account the appropriateness of the sharing of revenue with the country providing the capital. In addition, the United Nations Model Convention embodies the idea that it would be appropriate for the residence country to extend a measure of relief from double taxation through either foreign tax credit or exemption as in the OECD Model Convention.

In using the United Nations Model Convention, a country should bear in mind the fact that the relationship between treaties and domestic law may vary from country to country and that it is important to take into account the relationship between tax treaties and domestic law. Tax treaties affect the tax rules prevailing under the domestic tax laws of the Contracting States by establishing which Contracting State shall have jurisdiction to subject a given income item to its national tax laws and under what conditions and with what limitations it may do so. Consequently, countries wishing to enter into bilateral tax treaty negotiations should analyse carefully the applicable provisions of their domestic tax laws in order to assess the modifications that might be required if the treaty were applied.

It may also be noted that domestic tax laws in their turn exert an influence on the content of bilateral tax treaties. Thus, although there was general agreement in OECD about the principles embodied in the OECD Model Convention and although most existing bilateral tax treaties conform by and large to the latter, there are often substantial variations from one treaty to another, due to differences in the domestic laws of the various Contracting States.